

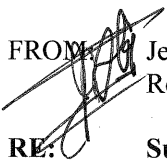
STATE OF MAINE REVENUE FORECASTING COMMITTEE

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March 1, 2010

TO: Governor John Baldacci
Members, 124th Legislature

FROM:  Jerome Gerard, Chair
Revenue Forecasting Committee

RE: **Summary of March 2010 Revenue Forecast**

The Revenue Forecasting Committee (RFC) met on February 23, 2010 to review its December 1, 2009 revenue forecast and has revised its revenue projections through the fiscal year ending June 30, 2013 for the General Fund, Highway Fund and the Fund for a Healthy Maine to comply with the statutory March 1st reporting date. This letter with attachments represents a summary of the major findings and recommendations of the RFC. A more detailed report will be available later and posted to the RFC's web site as soon as it is completed.

This March 2010 update, which began with the Consensus Economic Forecasting Commission's (CEFC) update of the economic forecast, breaks a string of significant downward revenue revisions that reflected the deteriorating national economy. The CEFC's update resulted in very modest changes to the economic forecast with the most significant adjustments reflecting a partial reversal of the calendar year 2009 changes to Personal Income that was a result of revisions to data compiled by the federal Bureau of Economic Analysis. A copy of the February 2010 report of the CEFC is available on the web at:

http://www.maine.gov/legis/ofpr/revenue_forecasting_committee/consensus_economic_forecast/feb2010.pdf

The modest revisions to the CEFC's economic forecast produced insignificant changes in the revenue forecast. The normal historical relationship between the economic forecast and revenue performance has been altered during this recession as a result of the unprecedented reaction of the consumer. Maine Revenue Services' tax models have been unable to adequately capture consumer behavior despite recent additions of new economic variables to improve modeling of consumption patterns. Maine's sustained decline in taxable sales over the last 2 years has been unprecedented. The RFC and the CEFC have been meeting jointly and will continue to try to improve our forecasting processes, particularly in the area of consumer behavior.

As with prior revenue forecasts in this recession, the RFC feels the need to express concern regarding the difficulty forecasting in this extremely volatile economic environment. While it appears the recession ended last summer and we are currently in the process of a slow economic recovery, most economists project that the recovery will shift into a mild, but sustained, economic expansion early next year. It is important to note, however, that the recovery remains fragile, and the weak recovery is highly susceptible to numerous risks both from within and outside the United States. The period between this forecast and the next RFC meeting later this calendar year will determine if the economy enters a new expansionary period or falters and returns to recession.

The following tables and narratives along with the attachments highlight the changes to each of the major funds and revenue sources included in this December 2009 forecast of the RFC.

General Fund Summary

| | FY09 Actual | FY10 | FY11 | FY12 | FY13 |
|---|--------------------|---------------------|---------------------|--------------------|--------------------|
| Current Forecast | \$2,811,368,295 | \$2,649,211,742 | \$2,721,503,989 | \$2,776,628,302 | \$2,889,913,034 |
| Annual % Growth | -9.0% | -5.8% | 2.7% | 2.0% | 4.1% |
| Net Increase (Decrease) | | \$29,817,638 | \$21,158,388 | \$2,336,418 | \$7,111,403 |
| Revised Forecast | \$2,811,368,295 | \$2,679,029,380 | \$2,742,662,377 | \$2,778,964,720 | \$2,897,024,437 |
| Annual % Growth | -9.0% | -4.7% | 2.4% | 1.3% | 4.2% |
| Summary of Revenue Revisions by Major Revenue Category | | | | | |
| Sales and Use Tax | | (\$13,814,276) | (\$16,994,778) | (\$19,111,598) | (\$20,938,394) |
| Individual Income Tax | | \$13,400,000 | \$2,000,000 | (\$14,000,000) | (\$3,500,000) |
| Corporate Income Tax | | \$29,672,794 | \$36,678,367 | \$35,897,336 | \$32,397,422 |
| Other Taxes and Fees | | \$231,930 | (\$499,178) | (\$1,232,505) | (\$1,511,772) |
| Fines, Forfeits and Penalties | | \$651,875 | \$240,000 | \$240,000 | \$240,000 |
| Income from Investments | | \$295,664 | (\$577,445) | (\$577,445) | (\$577,445) |
| Transfer to Tax Relief Programs | | (\$500,000) | \$0 | \$0 | \$0 |
| Transfer to Municipal Rev. Sharing | | (\$1,223,365) | (\$1,128,368) | (\$274,489) | (\$384,027) |
| Other Revenues | | \$1,103,016 | \$1,439,790 | \$1,395,119 | \$1,385,619 |
| Total Revisions - Increase (Decrease) | | \$29,817,638 | \$21,158,388 | \$2,336,418 | \$7,111,403 |

| | | | | |
|--------------------------------------|-------------|-------------|-------------|-------------|
| Other Taxes and Fees Detail: | | | | |
| - Prop. Tax - Unorganized Territory | (\$152,793) | (\$282,779) | (\$291,824) | (\$359,424) |
| - Liquor Taxes and Fees | (\$694,500) | (\$854,500) | (\$854,500) | (\$854,500) |
| - Finance Industry Fees | \$109,950 | \$0 | \$0 | \$0 |
| - Milk Handling Fee | \$595,773 | \$375,476 | (\$139,615) | (\$139,615) |
| - Parimutuel and Gaming Revenue | \$342,500 | \$262,625 | \$53,434 | (\$158,233) |
| - Other Miscellaneous Taxes and Fees | \$31,000 | \$0 | \$0 | \$0 |
| Other Revenue Detail: | | | | |
| - Liquor Sales and Operations | (\$580,511) | \$0 | \$0 | \$0 |
| - Targeted Case Management (HHS) | \$464,371 | \$0 | \$0 | \$0 |
| - State Cost Allocation Program | \$27,625 | \$47,521 | \$0 | \$0 |
| - Tourism Transfer | \$14,725 | \$6,650 | \$9,500 | \$0 |
| - Other Miscellaneous Revenue | \$1,176,806 | \$1,385,619 | \$1,385,619 | \$1,385,619 |

General Fund revenue estimates are being revised upward by \$29.8 million in FY10 and \$21.2 in FY11, resulting in total increase in budgeted revenue of \$51.0 million for the 2010-2011 biennium. The upward revisions to the forecast for the 2012-2013 biennium are much less and total only \$9.4 million. Although this forecast revises projections upward, the preceding forecasts have reduced General Fund budgeted revenue so significantly that the General Fund revenue projection for FY13 remains more than \$190 million below peak collections in FY08 and almost \$35 million below what was received in FY06.

The dominating revision in this General Fund forecast is the change to Corporate Income Tax projections. As the result of an unprecedented reduction in cost structure, business profitability has returned and with it corporate income tax receipts. The RFC now projects that corporate income tax revenues will be \$66.4 million higher in this biennium compared to the last revenue forecast. Without this category's significant upward revision, this forecast for General Fund revenue would have once again resulted in a net downward revision for the biennium.

While Individual Income Tax revenue is now projected to be higher during the current biennium by \$15.4 million, most of the upward revision occurs in FY10. Long-term projections are revised downward as a result of lower growth rates for Personal Income growth beginning in 2011, but primarily result from a change of assumptions that a higher percentage of the change of income will affect lower income tax payers.

Sales and Use Tax is being revised downward throughout the forecast period. The downward revisions in this category largely ignore the output of the sales and excise tax model and represent a manual adjustment to current fiscal year revenue projections to meet actual performance. The manual adjustments assume negative variances of approximately \$2 million per month for the remainder of the fiscal year. Despite best efforts to add new explanatory variables to the models, the sales and excise tax component of the tax model has been unable to capture recent consumer behavior. As noted earlier, the recent extended decline in taxable sales and the reaction of the consumer to this economic downturn is unprecedented.

The net changes to the major tax lines that affect revenue sharing transfers remain positive throughout the forecast period and as a result increase estimates for the amount of revenue sharing to be distributed to municipalities throughout the forecast period. An additional \$2.35 million is projected to be distributed during the current biennium.

Other net General Fund changes increase revenue projections by a total of \$2.4 million during the current biennium. The largest increases result from changes in fine revenue, milk handling fee revenue, Racino revenue and Department of Health and Human Services revenue. These increases were partially offset by decreases in Income from Investments, liquor-related revenue and Unorganized Territory property tax transfers as well as higher than projected payments for the Tax Relief Programs. Additional background information has been posted to the following web address:

http://www.maine.gov/legis/ofpr/revenue_forecasting_committee/current/index.htm

Highway Fund Summary

| | FY09 Actual | FY10 | FY11 | FY12 | FY13 |
|---|--------------------|--------------------|--------------------|--------------------|--------------------|
| Current Forecast | \$324,242,149 | \$305,488,175 | \$301,626,331 | \$306,856,435 | \$311,455,041 |
| Annual % Growth | -1.2% | -5.8% | -1.3% | 1.7% | 1.5% |
| Net Increase (Decrease) | | \$4,003,591 | \$5,440,038 | \$5,209,059 | \$6,430,059 |
| Revised Forecast | \$324,242,149 | \$309,491,766 | \$307,066,369 | \$312,065,494 | \$317,885,100 |
| Annual % Growth | -1.2% | -4.5% | -0.8% | 1.6% | 1.9% |
| Summary of Revenue Revisions by Major Revenue Category | | | | | |
| Fuel Taxes | | \$5,013,500 | \$4,819,250 | \$5,540,750 | \$6,761,750 |
| Motor Vehicle Registration & Fees | | (\$1,000,000) | \$1,000,000 | \$0 | \$0 |
| Inspection Fees | | (\$150,000) | (\$150,000) | (\$150,000) | (\$150,000) |
| Fines, Forfeits and Penalties | | \$0 | \$0 | \$0 | \$0 |
| Income from Investments | | (\$31,292) | (\$46,691) | (\$46,691) | (\$46,691) |
| Other Revenues | | \$171,383 | (\$182,521) | (\$135,000) | (\$135,000) |
| Total Revisions - Increase (Decrease) | | \$4,003,591 | \$5,440,038 | \$5,209,059 | \$6,430,059 |

Highway Fund revenue estimates are revised upward by \$9.4 million for the 2010-2011 biennium, with \$4.0 million in FY10 and \$5.4 million in FY11. The forecast for the 2012-2013 biennium is also increased by \$11.6 million. With the exception of Fuel Taxes, there are modest net reductions from the other categories.

Much like the sales tax, the Fuel Tax forecast relies on the same sales and excise tax component of the tax model. For numerous possible reasons, this tax model component has had even greater difficulty capturing fuel tax consumption patterns. Some of the reasons include: a base year that reflected peak gas price consumption patterns with resulting conservation efforts; a potential floor on consumption due to the rural nature of the state and the lack of alternative transportation methods; and the potential increase in gasoline consumption from reduced fuel efficiency of the 10% ethanol-gasoline mix. During the December 2009 forecast, the RFC struggled with the significant diversion between actual revenue performance and the model outputs. At that time, the RFC decided to ignore the model changes for the gasoline portion of the forecast and accept the tax model's recommended changes in the special fuels (primarily diesel fuel) forecast. With the recent positive variances in the special fuels tax collections, the RFC decided to ignore all recent tax model recommendations for fuel taxes and revert back to the fuel tax forecast prior to the December 2009 revisions.

Fund for a Healthy Maine Summary

| | FY09 Actual | FY10 | FY11 | FY12 | FY13 |
|---|--------------------|------------------|------------------|-------------------|--------------------|
| Current Forecast | \$68,409,736 | \$59,398,770 | \$56,433,315 | \$62,835,233 | \$63,455,718 |
| Annual % Growth | 10.3% | -13.2% | -5.0% | 11.3% | 1.0% |
| Net Increase (Decrease) | | (\$6,807) | (\$9,779) | (\$14,856) | (\$109,354) |
| Revised Forecast | \$68,409,736 | \$59,391,963 | \$56,423,536 | \$62,820,377 | \$63,346,364 |
| Annual % Growth | 10.3% | -13.2% | -5.0% | 11.3% | 0.8% |
| Summary of Revenue Revisions by Major Revenue Category | | | | | |
| Racino Revenue | | \$0 | \$0 | \$0 | (\$92,222) |
| Income from Investments | | (\$6,807) | (\$9,779) | (\$14,856) | (\$17,132) |
| Total Revisions - Increase (Decrease) | | (\$6,807) | (\$9,779) | (\$14,856) | (\$109,354) |

The Fund for a Healthy Maine (FHM) was not appreciably affected in this revenue forecast. With no additional information available regarding the tobacco settlement payments, the RFC chose not to make any adjustments to this primary revenue source of the FHM. The only adjustments reflect lower assumptions for rates of return on cash pool earnings that reduced the Income from Investments for each year of the forecast period. The only other change reflects lowered future growth assumptions for slot machine revenue from Hollywood Slots in Bangor, referred to as Racino Revenue. FHM's share of Racino Revenue is being reduced in FY13 only, due to a recent legislative change that capped the transfers from this revenue source in FY10, FY11 and FY12.

Medicaid/MaineCare Dedicated Revenue Taxes Summary

| | FY09 Actual | FY10 | FY11 | FY12 | FY13 |
|-------------------------|--------------------|---------------|---------------|---------------|---------------|
| Current Forecast | \$138,029,363 | \$138,327,254 | \$137,555,805 | \$137,555,805 | \$137,555,805 |
| Annual % Growth | 6.0% | 0.2% | -0.6% | 0.0% | 0.0% |
| Net Increase (Decrease) | | \$0 | \$0 | \$0 | \$0 |
| Revised Forecast | \$138,029,363 | \$138,327,254 | \$137,555,805 | \$137,555,805 | \$137,555,805 |
| Annual % Growth | 6.0% | 0.2% | -0.6% | 0.0% | 0.0% |

Medicaid/MaineCare Dedicated Revenue Taxes have been performing consistent with the December 2009 forecast in aggregate. As a result, the RFC chose to make no adjustments for the March 2010 forecast.

Attachments

cc: Members, Revenue Forecasting Committee
 Members, Consensus Economic Forecasting Commission
 Jane Lincoln, Chief of Staff, Governor's Office
 Ryan Low, Commissioner, DAFS
 Millie MacFarland, Clerk of the House
 Joy O'Brien, Secretary of the Senate
 David Boulter, Executive Director, Legislative Council
 Legislative Staff Office Directors